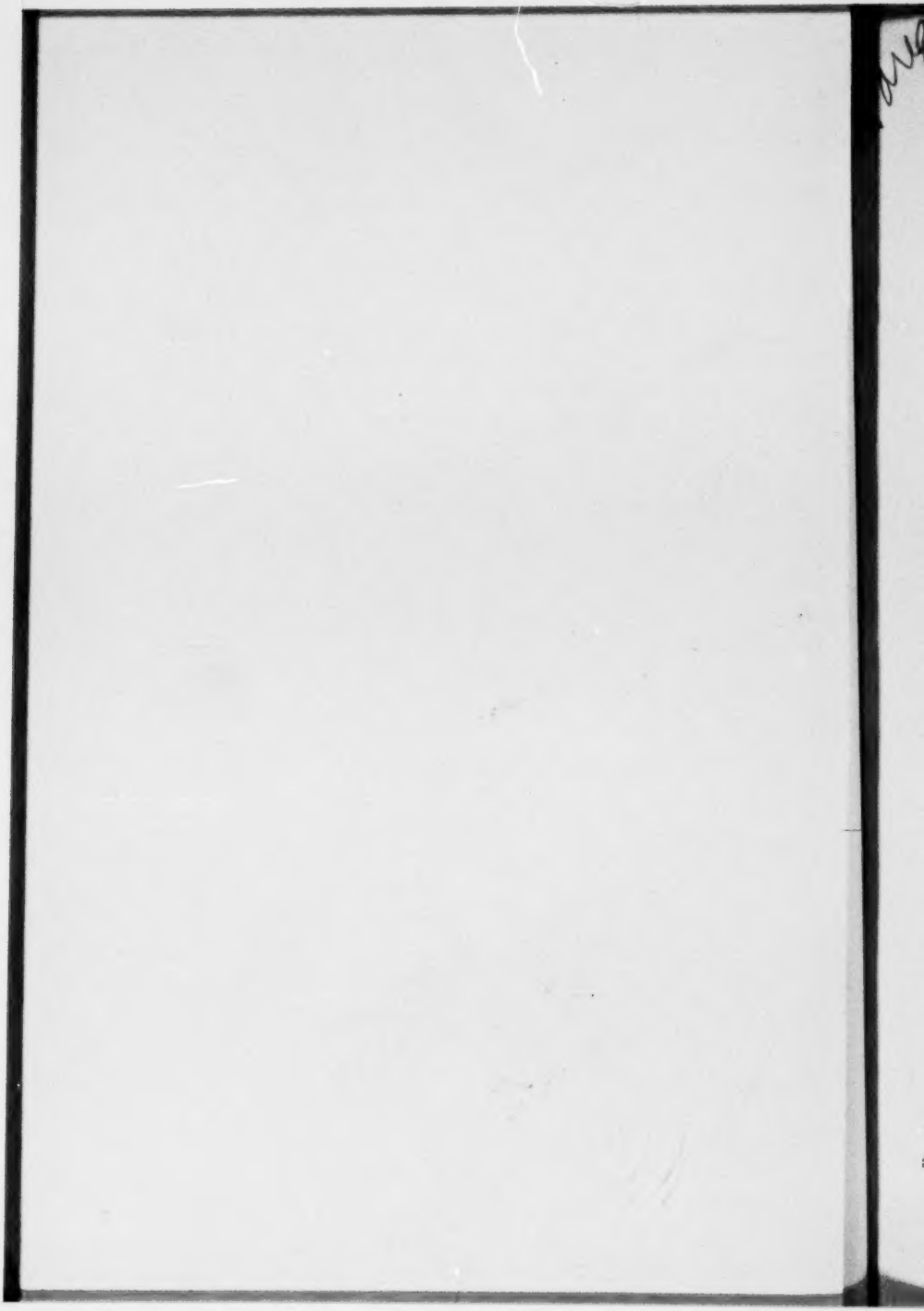

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CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 985

H. A. PHILLIPS,
TRUSTEE OF THE SOUTHERN BREWING COMPANY,
BANKRUPT, *Petitioner*,
v.
A. M. ARNOLD, *Respondent*

REPLY OF RESPONDENT

to

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

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MAY IT PLEASE THE COURT:

Respondent is unable to concur in petitioner's "Summary Statement of the Matter Involved" and "Statement of the Case" and respectfully presents the following

Statement of the Case

Petitioner sued respondent in the Bankruptcy Court praying for the cancellation of a deed of trust (mortgage) given

by the bankrupt corporation, Southern Brewing Company, four and one-half years prior to bankruptcy, to secure respondent, its controlling stockholder, for moneys loaned to the corporation during the years 1934 and 1935 and again in 1937 and 1938. He also sought cancellation of the trustee's deed given to respondent, Arnold, as the highest bidder at foreclosure of his deed of trust, which occurred over five months prior to bankruptcy and over a year after default took place. The deed of trust, dated September 5, 1934, covered certain premises occupied by the corporation and was duly filed for registration and recorded in accordance with the laws of the State of Texas (R. 147, 148; 207 to 213).

Petitioner's attack on the deed of trust was predicated on the theory that the corporation, while under the control of Arnold as its principal stockholder, could not give Arnold a valid deed of trust to secure the money loans made by him to the corporation. It was petitioner's contention that the bona fides of this transaction were immaterial; that the complete absence of any unfair or unconscionable dealing with the corporation was immaterial; that the fact that the transaction was conducted at arm's length in precisely the same manner as if the corporation had borrowed this money from a bank was immaterial; that the indisputable fact that the transaction was for the benefit of the corporation and its creditors was immaterial. Indeed, it was his position that the only thing that counted was that Arnold was the controlling stockholder of the corporation and that the transaction became void per se by reason thereof.

Respondent's control of the corporation as owner of all but two shares of its stock was readily admitted, it being his contention that this did not place him under any disability in conducting a good faith transaction with the corporation, particularly when such transaction inured to the great benefit of the corporation; that so long as it was fair and aboveboard in all respects, his position as controlling and

dominating stockholder would not serve to vitiate the transaction. He submitted the entire matter to the close scrutiny of the court with full confidence that unqualified good faith and fair dealing would be found to have existed throughout his dealings with the corporation and its creditors. He stood upon the undisputed showing that the corporation and its creditors received every cent of the money loaned by respondent to the corporation in this transaction and that the net result thereof was highly beneficial to the corporation and to its creditors (R. 52 and 54). As evidence of the openness of the transaction, respondent pointed to the registration of the deed of trust in accordance with the laws of Texas, this being the method prescribed for the giving of notice to all persons of such a transaction.[1] None of the debts existing at the time of bankruptcy were owing by the bankrupt corporation at the time this deed of trust was placed of record; accordingly, each of the bankrupt's creditors had notice of this deed of trust and of respondent's rights thereunder at the time credit was advanced to the bankrupt corporation (R. 54). As proof of utmost good faith toward and fair play with the creditors, respondent also pointed to his refusal to draw any salary after October 31, 1936, although he actively managed the business of the corporation until May, 1938 (Referee's Certificate R.

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[1]Article 6646 of the **Revised Civil Statutes of Texas, 1925**, provides: "The record of any grant, deed or instrument of writing authorized or required to be recorded, which shall have been duly proven or acknowledged for record and duly recorded in the proper county, shall be taken and held as notice to all persons of the existence of such grant, deed or instrument." The Texas Supreme Court has held (**Quarles v. Hardin,** 249 S.W. 459; **Quarles v. Eaton Blewett Co.,** 249 S.W. 465) that compliance with this statute 'took the place of and was tantamount to actual knowledge" of the existence of such instrument and that such registration "charges every one with notice of its execution and contents." All creditors, general and unsecured, as well as lien creditors come within the scope of this statute. **Perry v. Brown,** 76 S.W. (2d) 230; **Martin v. Jourdanton,** 185 S.W. 583; **Sikes v. Bank,** 197 S.W. 227; **Maryland Casualty Co. v. Willig,** 10 S.W. (2d) 415.

61 and 62); to his passing up of interest collections on the loans to the corporation (Referee's Certificate Article XVII R. 62); to his refusal to draw one cent of dividend from the corporation throughout its existence (Referee's Certificate Article XX R. 65).

Petitioner made no complaint under the Federal Fraudulent Transfer Act, Title 11, Section 107, U.S.C.A., nor did the evidence raise any question falling within the provisions of that Act. Unlike certain innuendoes now appearing in the petition for writ of certiorari, petitioner in his petition below did not allege any express or intended fraud (R. 11-15, inc.). The Referee in Bankruptcy, after careful inquiry into and painstaking scrutiny of all of the dealings between the corporation and respondent and the corporation's creditors, failed to find a single fraudulent act, or any evidence of mismanagement or manipulation (R. 45 to 69, inc.). The District Court found none and the Circuit Court found none. It is apropos to notice the words of the Circuit Court: "We find here no proof of mala fides, or that the money was not fully paid to and used by the corporation in an honest effort to carry on its business" (R. 289); and again: "There is nothing to show the enterprise was entered upon or prosecuted with a fraudulent purpose" (R. 286).

The Referee in Bankruptcy and the District Court, although finding no fraud, mismanagement or manipulation, set aside the deed of trust on the bald proposition urged by petitioner that the control of the corporation by Arnold, placed him under absolute disability to become its creditor under any circumstances, even though the result of the transaction was a distinct benefit to the corporation. The good faith of the transaction and the fairness with which it was conducted were entirely ignored, as was the beneficial result thereof to the corporation and its creditors. The Circuit Court, while fully recognizing the rule that where fraud or

unconscionable conduct results from the transaction between the dominant figure in a corporation and the corporation, such transaction will be voided, followed the rule prevailing in Texas as well as in the Federal jurisdictions, that the acts between such parties will not be condemned where scrutiny reveals good faith and fair dealing. Because approximately $50,000.00 of the indebtedness secured by the deed of trust represented the balance of sums loaned to the corporation within a year after its incorporation, the Circuit Court, in disallowing same, held that it would treat such loans as contributions to the capital and not as an indebtedness. The loans made during the years 1937 and 1938,—after the corporation had been operating for over four years, aggregating in principal $47,050.00, the court held valid in every respect and, as to this indebtedness, upheld the deed of trust (R. 288). The trustee's deed given after foreclosure, not recorded until after bankruptcy, was set aside (R. 289). This petition, therefore, involves only the validity of the loans made in 1937 and 1938.

Other salient facts, undisputed and incorporated in the findings of the Referee, apparently considered unimportant by petitioner, but which respondent submits as facts highly pertinent to a proper consideration of this petition, are:

1. The Southern Brewing Company was duly and regularly incorporated under the laws of the State of Texas on July 12, 1933, and existed as such on the date of bankruptcy (R. 50-51).

2. The brewery assumed larger proportions, as time went on, than had been originally planned. Extensive improvements were made to include a bottling shop in addition to the keg brewery (R. 51).

3. Cancelled checks supporting each of the loans made by respondent Arnold to the corporation were intro-

duced in evidence and the corporation received the full use of this money (R. 52; 55 and 56).

4. At the time of the filing of the deed of trust for registration in accordance with the laws of Texas, none of the debts owed by the bankrupt corporation on the date of bankruptcy were in existence (R. 54).

5. In July, 1936, the corporation paid respondent the sum of $20,000.00 and in August, 1936, the sum of $7,400.00. Both of these payments were applied against the deed of trust note. In 1936, the corporation had a splendid year and made a nice profit in its business and thus was enabled to make these payments (R. 55).

6. In the words of the Referee "A large part of the profits of 1935 and 1936 were put into additions to the plant" (R. 65).

7. In the first four months of 1938—several months after default had been made in the payment of the deed of trust note, respondent loaned the corporation $30,000.00 additional under the provisions of the deed of trust. Under the terms of the deed of trust respondent could have foreclosed on September 5, 1937, but he continued not only to bear with the corporation but loaned it $37,050.00 more thereafter, which are loans here involved. *This entire amount went to the benefit of the creditors, as Arnold drew no salary and was paid no interest after that time* (R. 65, 62, 55 and 56).

8. All three directors of the corporation, two besides Arnold, approved the action of the corporation in giving this deed of trust to secure the loans obtained from Arnold (R. 188-189; 149).

9. The corporation was capitalized for a very substantial amount, to-wit, $50,000.00 all of which was paid in cash (R. 50 and 51). The additional money needed within a few months after incorporation was due, in part, to the addition of a bottling shop, when originally it had been planned to operate only a keg brewery (R. 51).

Reply to Petitioner's Argument[1]

A.

Petitioner, in commenting upon the transactions between Arnold and the corporation, employs such words as "manipulation," "unfair dealing" and kindred harsh-sounding terms. There are no pleadings to support such charges—not one whit of evidence upon which to base them. A searching survey of the dealings between Arnold, the corporation and its creditors by the Referee in Bankruptcy failed to produce a single finding of unfairness, manipulation or overreaching. The District Court found none and the Circuit Court in a very comprehensive review of the facts affirmatively stated that no mala fides was present; that there was "nothing to show the enterprise was entered upon or prosecuted with a fraudulent purpose" (R. 286); that the money loaned to the corporation by Arnold was "used by the corporation in an honest effort to carry on its business" (R. 289). It thus seems clear that these charges and intimations, so foreign to the record, have sprung up in a desire to affix some application of the rule announced in the PEPPER v. LITTON case, 308 U.S. 295 to the instant case. Indeed the petition is bottomed primarily on an effort to analogize this case with the PEPPER case and the case of TAYLOR v. STANDARD GAS & ELECTRIC COMPANY, 306 U.S. 307. Such attempted alliance is insupportable, the factual bases in each being widely divergent. Only a casual comparison of the controlling facts in the instant case with those in the two cited cases reveal these basic dissimilarities:

The PEPPER case involved an effort on the part of a sole stockholder of a corporation to wrongfully divert its assets

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[1]The reply is divided into Sections A and B, to correspond with the segregation adopted by petitioner.

through a "planned and fraudulent scheme" pursuant to which he conjured up large and exorbitant salary claims, which appeared to be nothing more or less than bookkeeping entries. This scheme was carried forward through the employment of various furtive steps, each executed in a sinister and shockingly fraudulent manner. The proof not only showed the presence of glaring fraud from the time of the conception of the scheme to its conclusion, but an acquisition on the part of the sole stockholder, Litton, of the assets of the bankrupt (in the words of the court) "not for cash or other consideration of value to creditors but for bookkeeping entries representing at best merely Litton's appraisal of the worth of Litton's services over the years." The facts presented a strong situation for the application of the rule that a sole stockholder cannot deal with the corporation in a manner resulting in fraud of the rights of third persons. In the TAYLOR case this Court held that the claim of Standard Gas & Electric Company against its subsidiary should be allowed to participate in the reorganization plan of the subsidiary only in subordination to the preferred stock of the subsidiary. This holding was bottomed on the conclusive showing of gross mismanagement and faithless stewardship of the affairs of the subsidiary by Standard to the detriment of the public investors. The striking acts of mismanagement and general unconscionable conduct there present made it a proper case for this rule to be applied.

Not the remotest kinship do these two cases hold to the case at bar. In the instant case the transaction was open and aboveboard, attendant with unquestioned good faith every step of the way. In fact, it presents a striking antithesis to the factual situations in the PEPPER and TAYLOR cases. Not only was there absent any vestige of fraud or bad faith but the lending of the money by Arnold to the corporation in 1937 and 1938 presented a commendable effort to aid the corporation in meeting its debts and needs; it involved a loan of money the

full benefit of which the corporation and its creditors received. It was an arm's length transaction which not only inured to the benefit of the corporation and its every creditor but of which act every creditor existing at the time of bankruptcy had notice before extending credit to the corporation. The undisputed facts showed that the corporation had been in business for several years when these particular loans were made; that it had previously enjoyed some prosperity and made substantial additions to its plant in 1935 and 1936 (R. 65), but in 1937 and 1938 found itself in need of money (R. 55 and 56). Business conditions in the brewing industry became worse and sizeable amounts of bad accounts had to be charged off (R. 176, 177). The corporation's distributing agency was having difficulty in making collections and could not pay its account (R. 136, 137, 138). These loan transactions were every bit as open, as fair and as legitimate as if the corporation had gone to a bank and borrowed the same amount of money.[1] That the corporation had to have the money to continue its business is not denied; that the terms of the loan were very reasonable must be admitted; that the corporation received the full use and benefit of every penny of these loans and that the creditors profited thereby is proven by the undisputed facts. It follows conclusively that no basis exists for any complaint.

If the rule contended for by petitioner is to be adopted it would preclude every stockholder owning fifty-one per cent or more of the stock of the corporation from lending money to the corporation in time of need. This is true because it must be conceded that a stockholder owning fifty-one per

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[1] As said by the Circuit Court: "Had this corporation borrowed of a bank upon the security of the plant, the debt would no doubt be valid. What would render it invalid when Arnold furnished the money? * * * The money went to relieve the needs of the business exactly as it would have done if a bank had advanced it. No other creditor was prejudiced or misled."

cent of the stock of a corporation is just as much in position to control and dominate the corporation as is one owning ninety-eight per cent of the stock. Such a rule would work an extreme hardship on many corporations, especially smaller ones. Such corporations frequently cannot obtain loans from banks or other institutions and there is no one left to come to its rescue other than the man who is interested in the corporation. It is submitted that the test of validity is now and should remain to be—not the extent of the interest of the lender in the corporation—but the fairness and honesty of the transaction.

The primary reason why the Referee in Bankruptcy and the District Court on the one hand, and the Circuit Court on the other, reached different conclusions lies in the failure on the part of the former to give effect to the rule that a contract between a corporation and its controlling figure, or all of its officers or all of its directors, as the case may be, is not void per se but that it may be avoided for unfairness or fraud. This rule is well settled in Texas and in Federal jurisdictions. The outstanding decision in Texas on this point is ZORN V. BROOKS, ET AL., 83 S.W. (2d) 949, by the Commission of Appeals, opinion adopted by the Supreme Court of Texas, which was completely ignored by the Referee and the District Court but given full effect by the Circuit Court. The Brooks Supply Company, a corporation, managed and dominated by T. D. Brooks, conveyed certain properties to Brooks. The transfer was attacked by the Trustee in Bankruptcy and in passing thereon the Supreme Court of Texas said:

> "The authorities generally are in complete accord in declaring that a contract between a corporation and one or all of its officers and directors is not void per se, but that it may be avoided for unfairness or fraud. (Citing numerous cases.) This is the settled rule in Texas." (Citing numerous cases.)

Typical of the decisions of the Federal Courts on this question is the case of McCLEAN v. BRADLEY, 299 Fed. 379, certiorari denied, 266 U.S. 619, where it was held that directors are not prohibited from lending money to the corporation "when it is needed for its benefit, and the transaction is open and otherwise free from blame."[1]

It is plain—and this fact is not disputed by petitioner—that if Arnold had not made this loan to the corporation it would have been compelled to seek a loan through some money lending agency in an effort to honestly continue its business. Assuming that some financial agency would have felt interested in making the loan, the conclusion is inescapable that the corporation and its creditors would not have fared nearly so well under such an arrangement as they did under the loan made with Arnold. He bore with the corporation long after it had made default; in fact, continued to make additional loans in an effort to help it survive (R. 65, 62, 55 and 56). He collected no interest in 1937 and 1938 when business conditions were unfavorable (R. 62). He drew no salary during those years (R. 61 and 62). In 1936 when the business showed a splendid profit, a substantial amount was applied to this indebtedness in an effort to cut it down, but in 1937 and 1938 when the business of the corporation suffered from conditions beyond its control, Arnold not only continued to pump $47,050.00 additional money into the corporation to give it additional life, but he did so without even receiving interest on the loans theretofore made (R. 65, 62, 55 and 56). This is conclusive evidence of good faith

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[1] Numerous Federal decisions to the same effect exist. In fact, the rule appears to be uniform. Other Federal cases are **Twin-Lick Oil Company v. Marbury**, 91 U.S. 587; **Rinn v. Asbestos Manufacturing Company**, 101 Fed. (2d) 344, certiorari denied, 308 U.S. 555; **Des Moines Terminal Company v. Des Moines Union Railway Company**, 52 Fed. (2d) 616, certiorari denied, 285 U.S. 537 (holding that question of good faith is the test of validity of contracts between the individuals interested in a corporation and the corporation itself).

and fair dealing for had Arnold not been imbued with a keen desire to promote the welfare of the corporation and its creditors, he could have foreclosed his deed of trust in 1937 without having to feed an additional $47,050.00 into the corporation's treasury. In considering the fairness of Arnold's conduct towards creditors, it should be noted that not one cent of dividends did he draw from the corporation and except for the year 1936, when the corporation showed a large profit, Arnold's salary withdrawals were very nominal, with no salary being charged for the years 1937 and 1938. Of the salary previously charged, Arnold permitted the sum of $9,570.98 to remain in the treasury of the corporation and this amount the corporation still owed him at the time of bankruptcy (R. 63). In other words, for his labors as president and general manager of the corporation from the time of its organization in 1933 until he parted with his stock in 1938, Arnold received no dividends, only a partial payment of interest and of the small salary credited to his account on the books of the corporation, over $9,000.00 was never withdrawn.[1] That these salient facts favorably stand the test of fairness and good faith cannot be questioned.

In Texas one-man corporations are regarded as separate entities and their transactions are considered legal and valid.[2]

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[1] The reference made by petitioner to Arnold's alleged "withdrawals" of "more than $90,000.00" throughout the corporation's existence is incorrect (R. 62 and 63). The amounts actually paid Arnold consisted principally of approximately $50,000.00 payments on loans Arnold made the corporation in 1934 and 1935 (R. 61 to 65, inc.).

[2] Among the numerous Texas cases announcing this rule are **Noblitt v. Barker,** 97 S.W. (2d) 1010, writ of error refused by Supreme Court; **Sayers v. Navillus Oil Company,** 41 S.W. (2d) 506, writ of error refused by the Supreme Court; **Staacke v. Routledge** (Supreme Court), 241 S.W. 994.

The same rule has been followed by the Federal Courts, typical of which is PLANTERS' COTTON OIL COMPANY, INC. v. HOPKINS (Fifth Circuit), 53 Fed. (2d) 825, wherein the court said:

> "It is the general rule that the corporation and the stockholders are essentially distinct entities, and that though to circumvent fraud the corporate entity may be regarded as a fiction, ordinarily it must be regarded as having a real, a substantial, existence. (Citing cases.) Nor does the fact that one person owns all or substantially all of the stock of the corporation at all change the rule." (Citing cases.)

The foregoing review of the facts in this case and of the rules of law applicable thereto demonstrates the fallacy of the contention that the decision in this case conflicts with the decision of this Court in the TAYLOR and PEPPER cases. Equally as unfounded is the assertion that the decision in this case is in conflict with certain cases decided by the Circuit Court of Appeals and listed on top of page 5 of the petition. There is nothing in any of these cases inconsistent with the decision in this case. None of the transactions under inquiry in those cases involved an open, good-faith transaction under which the corporation and the creditors were benefited; in fact, the situation in each case was such as to require the disregard of the corporate entity in order to avoid fraud or injustice. The same is true of the Texas case (UNITED STATES AND MEXICAN TRUST COMPANY v. DELAWARE CONSTRUCTION COMPANY, 112 S.W. 447) referred to in the footnote on page 15 of petitioner's brief. In that case the stockholder was guilty of a clear wrong, in that he had become heavily indebted to the corporation and to prevent the occurrence

of an injustice occasioned by the stockholder's own wrong and dereliction a recovery was denied.[1]

Reference is made in petitioner's brief to the organization of Monte Carlo Distributing Corporation which acted as the distributing agency of the product manufactured by the bankrupt corporation. The reference leaves the impression that Arnold made some character of profit through this corporation. This is incorrect. Arnold did not draw, either directly or indirectly, one cent from the Monte Carlo Distributing Company. He did not even draw a salary from this company (Referee's findings, R. 64). This is but further evidence of the complete fairness he exercised toward the corporation and its creditors. The reason for the indebtedness of this subsidiary distributing company to the parent company was fully explained (R. 135 to 142) and the Referee made detailed findings of fact thereon (R. 64 and 65).[2]

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[1] The following excerpt shows the basis of the court's holding: "The principles of equity forbid that a shareholder by whose dereliction the assets of an insolvent corporation have been depleted could, as a creditor, share equally with other creditors in the distribution of those assets until he had made amends for his own wrong, or discharged his own obligation to that corporation."

[2] As to the Monte Carlo Distributing Company, the Referee found as follows:

> "The Monte Carlo Company at one time had as many as ten branches in various cities in Texas and had as many as 50 to 60 employees who were paid by it. The largest of these branches was at San Antonio and it was the only one in operation at the time of bankruptcy herein or for some time prior thereto. At the time of bankruptcy the San Antonio branch of Monte Carlo owned accounts receivable in the amount of approximately $10,000. There was evidence that the other branches also owned accounts but the amount was not established. Most of these other branches had been closed for more than a year prior to bankruptcy. Through the years of the existence of Monte Carlo, it had to charge off certain of its accounts as uncollectible, the amount so charged off not being shown in the evidence. Payments were made by it on the Southern

Petitioner's suggestion that the loans made in 1937 and 1938 should be called "contributions to capital" is extremely far-fetched. If Arnold's advances to the corporation in 1933 and 1934 are to be considered contributions to the capital as held by the Circuit Court, the corporation, in 1934, had a capital in excess of $125,000.00. It conducted its business with good profit in 1935 and 1936 and made substantial additions to its plant in those two years (R. 65). Its sound capital and financial structure prior to the making of these loans is demonstrated by the audit ending with the fiscal year date of October 31, 1936 (Exhibit C, R. 239-241) showing assets of $261,145.15, liabilities only $136,122.25. In the latter figure is included the unpaid balance of Arnold's 1933 and 1934 advances, which when considered as capital contributions in line with the Circuit Court's opinion, leaves the liabilities as only approximately $85,000.00—against assets worth $261,145.15. This audit was identified and fully explained by petitioner's witness, E. C. Smith (R. 109-111), who prepared it. In the light of these facts, it must be conceded by petitioner that the words of the Circuit Court, "They (1937 and 1938 loans) were truly loans and not new capital" present a correct conclusion.

B.

The second contention advanced by petitioner, that the

Brewery account right along, but these payments were always falling a little behind the charges.

"'Neither Arnold nor Otto drew any salary from the Monte Carlo Company. Otto, who was its secretary from May 20, 1935, to the date of bankruptcy, knew of no instance where the Monte Carlo Distributing Company diverted any of its assets other than to the payment of the Southern Brewing Company account as far as it could pay it. He also knew of no dividends ever paid by the Monte Carlo Company. The testimony also showed that it was the experience of breweries generally to have a substantial amount of uncollectible accounts occurring in their business despite reasonable efforts to avoid it.'" (R. 64 and 65.)

deed of trust is invalid because "not properly authorized by any qualified representative of the bankrupt" must fail. In the first place, petitioner's factual premise is erroneous; next, even if the facts were as stated by the petitioner, the instrument would still be valid under the Texas authorities.[1]

In his discussion petitioner proceeds as if Arnold had obtained this deed of trust without the knowledge or approval of the other two directors of the corporation. The undisputed testimony of both the witness Otto and Arnold is to the contrary. Arnold testified that at the meeting when this matter was discussed were present M. H. Otto, one of the directors, Mr. Arnold another of the directors and an attorney, W. D. Orem (R. 188-189). The witness Otto testified to exactly the same facts (R. 149; 167). The undisputed testimony further shows that subsequent to this meeting the matter was taken up with the third director, Mrs. Ida L. Arnold (R. 189). Even if there had been no formal meeting, its validity could not be challenged on that ground because the corporation received and accepted the full benefit of the transaction. After the execution of the deed of trust, which provided for future loans as well, the corporation received, accepted and used for its and the creditors' benefit the full fruits of this transaction. A plainer case of ratification and estoppel is hardly conceivable.

The fact that the controlling director, Arnold, was adversely interested to the corporation in this transaction does not, as petitioner contends, invalidate the instrument. All of the directors could have been adversely interested and it would still require a showing of unfairness or fraud before the instrument could be set aside. This is the settled rule in Texas as so clearly appears from the pronouncement of the

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[1] Petitioner concedes that this question is controlled by Texas law. In this respondent fully concurs.

Supreme Court of Texas in the case of ZORN v. BROOKS, supra, viz.:

> "The authorities generally are in complete accord in declaring that a contract between a corporation and one or all of its officers and directors is not void per se, but that it may be avoided for unfairness or fraud. (Citing numerous cases.) This is the settled rule in Texas." (Citing numerous cases.)

The case of TENISON v. PATTON, 95 Texas 284, cited by petitioner in support of his contention, not only fails to sustain petitioner but expressly holds that a corporation can deal with its officers and directors, and that even a sale by a director to the corporation is valid "if he makes a full disclosure of all facts known to him about the subject, takes no advantage of his position, deals honestly and openly, and concludes a contract fair and beneficial to the company."[1]

Additional Reason Why Petition Lacks Merit

As Trustee in Bankruptcy, petitioner may avoid any transfer or encumbrance by the bankrupt which any creditor might have avoided had bankruptcy not intervened. As a prerequisite to recovery, it is essential for the trustee to prove that he represents some creditor who could have avoided such transfer or encumbrance. Since all of the creditors represented by petitioner admittedly are "subsequent creditors"— cred-

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[1] The right of officers and directors to transact business with the corporation has been long recognized in Texas. One of the more recent cases, **Wolfe v. State Investment Company** (Civil Appeals), 95 S.W. (2d) 511, involved the execution of a deed of trust on the assets of the corporation to a stockholder to secure a loan. In upholding the transaction, the court said: "A corporation has the right to transact business with its directors and stockholders."

itors whose claims and rights arose subsequent to the execution and recordation of the deed of trust, none of such creditors could have attacked the deed of trust in question, had bankruptcy not intervened. Accordingly, the trustee is without standing to make this attack.

The undisputed evidence shows, and it was so found by the Referee (R. 54), that none of the debts owing at the time of bankruptcy were in existence at the time of the execution and recordation of the deed of trust.

The rule here invoked is well established by numerous Federal and Texas decisions. In KAMINSKY v. PHINIZY (Fifth Circuit), 54 Fed. (2d) 16, the Trustee in Bankruptcy sought to recover from Kaminsky moneys obtained from the corporation for a stock sale transaction to the corporation. The court held that "the transfer of the bankrupt's money was not subject to be avoided at the instance of the Trustee in Bankruptcy, unless it might have been avoided by a creditor of the bankrupt." * * * "If that transfer was voidable by anyone, when bankruptcy occurred, it was not avoidable by a creditor other than one who was a creditor when the transfer was made."

Similarly in PERROW v. SCOTT (Fourth Circuit), 275 Fed. 46, the trustee sought to set aside a deed of trust on the claim that it was fraudulent and void as to debts of the bona fide creditors of the bankrupt. In denying recovery the Circuit Court said:

> "Moreover, and this of itself would appear sufficient, the trustee's petition does not allege, and no attempt was made to show, that any of the parties in whose behalf this belated attack is made were creditors of the bankrupt at the time the deed of trust was executed and recorded. It is not for them to say that the security is fraudulent."

To the same effect are the following cases: NATIONAL BOND

& INVESTMENT COMPANY v. JONES (Sixth Circuit), 78 Fed. (2d) 601; CITY OF FORT WORTH v. NATIONAL PARK BANK OF NEW YORK (Fifth Circuit), 261 Fed. 817; WILKINSON v. WALKER, 294 Fed. 939.

This rule is well recognized in Texas. COPPARD v. GLASSCOCK, ET AL., 46 S.W. (2d) 298, by the Commission of Appeals of Texas, holding approved by the Supreme Court of Texas, wherein it was held that subsequent creditors could not attack a fictitious deed of trust; ARANSAS PASS HARBOR COMPANY v. MANNING (Supreme Court), 94 Tex. 558; ZORN v. BROOKS, 83 S.W. (2d) 949, by the Commission of Appeals, opinion adopted by the Supreme Court.[1]

Under the foregoing authorities, it is clear that it is incumbent on the trustee to plead and prove that he represented some creditor who could have avoided this transaction. There is neither pleading nor one scintilla of proof to show that the trustee represents a single creditor whose debt was in existence at the time the loans in question, or the last of them (R. 55 and 56) were made.

Conclusion

It is respectfully submitted that the petition for writ of certiorari not only fails to show any conflict in this decision and other decisions of this Honorable Court or any of the Circuit Courts, but fails to disclose any error in the determination made. That the decision is fully just to petitioner seems plain.

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[1] Other Texas cases reiterating this rule are **Blades v. Schmidt,** 110 S.W. (2d) 158 (Civ. App.); **Hall v. Crawford and Delphenis,** 11 S.W. (2d) 804 (Civ. App.).